No. 439

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CHARLES ELMORE CROPLEY
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# Supreme Court of the United States

C. C. FLETCHER AND E. E. WAKEMAN, as surviving Trustees of the Standard Bentonite Company, a trust,
PETITIONERS,

vs.

FRANK G. CLARK, as Collector of Internal Revenue for the Collection District of Wyoming,
RESPONDENT.

## PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS, TENTH CIRCUIT

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MAY IT PLEASE THE COURT:

The petition of C. C. Fletcher and E. E. Wakeman, as surviving Trustees of the Standard Bentonite Company, a trust (hereinafter sometimes called "petitioners' trust"), respectfully shows to this Honorable Court:

### I. JURISDICTION

The jurisdiction of this Honorable Court is invoked under Section 240 (a) of the Judicial Code, as amended by

the Act of February 13, 1925 (28 USCA 347), to review the judgment (R. 93) of the United States Circuit Court of Appeals, Tenth Circuit, entered July 5, 1945, in favor of respondent here (Appellee below), the mandate being stayed (R. 94) on petitioners' motion for a period of thirty days from August 9, 1945.

## II. THE QUESTIONS

(1) Which is the proper test to be applied to determine whether a trust is taxable as an individual or as an association: (a) that applied by the Sixth Circuit in *Gibbs-Preyer Trusts Nos. 1 and 2* (1941), 117 Fed. 2d. 619; or, (b) the diametrically opposed test applied by the Tenth Circuit in the instant matter? (Conflict between circuits.)

(2) Does the United States have power to tax income actually from property held in trust as though it were the income of an association or corporation, in view of the command of Section 161 (a) of the Internal Revenue Code that "The taxes imposed by this chapter upon *individuals shall apply to the income . . . of any kind of property held in trust . . .*"? (Emphasis supplied.) (Unsettled and important question of Federal law.)

(3) Can it be said that a trust is a business trust and not a mere liquidating trust where, as here, the trustees converted corpus into cash (R. 26, 27) and are without power to invest or reinvest in other property? (Trust Instr., R. 6 to 10.) (Unsettled and important question of Federal law.)

(4) Do the decisions by this Honorable Court in *Helvering v. Coleman-Gilbert Associates* (1935), 296 U. S. 369 and companion cases in 296 U. S. mean that granted but admittedly unused powers (R. 26, 27), as in the instant case, permitting the trustees to engage in business, inevitably make the trust taxable as an association? (Probable conflict between Tenth Circuit and this Honorable Court.)

(5) Is it not possible for petitioners to act in a dual capacity under the provisions of their trust instrument (Trust Instr., R. 7), so that they are (a) *trustees* merely for the purpose of holding legal title to the trust corpus;

and, (b) are *agents* for the beneficiaries in performing every other act? (Probable conflict of Opinion below (R. 89) with *A. A. Lewis & Co. v. Commissioner* (1937), 301 U. S. 385.)

(6) Where, as here, the liability of the beneficiaries of a trust is not limited (R. 25); where, as here, certificates of beneficial interest in the trust are to be transferred only by a separate instrument executed with the formalities of a deed (R. 24); and where, as here, the interest of any beneficiary may be sold (R. 25) by the trustees in default of contribution by the beneficiary of his share of the expense of assessment work required to be done to hold title to the corpus; and where, as here, numerous other characteristics of a corporation are lacking (R. 25), is such a trust taxable as an association? (Probable conflict of Opinion below (R. 89) with *Morrissey et al. v. Commissioner* (1935), 296 U. S. 344.

(7) In the face of Section 161 (a) of the Internal Revenue Code, which says that the taxes imposed upon *individuals* "shall apply to the income of any kind of property held in trust" may petitioners' trust be taxed as an association on income exclusively from property held in trust (R. 26, 27), merely because of the existence in the trust instrument of unused powers? May it be classified and taxed because of what it did *not* do? (Probable departure from usual course of judicial proceedings.)

## III. SUMMARY STATEMENT OF THE MATTER INVOLVED

The Findings of Fact by the trial Court (R. 22 to 27) are not disputed and references to the Record for facts will refer to the Findings, unless otherwise indicated.

This is a suit for refund of corporation income taxes for the calendar years 1940, 1941 and 1942, collected by respondent from petitioners' trust in the aggregate amount of $25,926.52 for the three years, respondents' theory being that petitioners' trust is a business trust, taxable as an association. (R. 22.) The Court below sustained respondent. (Opinion below, R. 89.)

Petitioners' trust was created in 1929 by a trust deed and agreement (R. 23), whereby eighteen individuals quit-claimed their several interests in six bentonite bearing placer mining claims located in Crook County, Wyoming (Trust Inst., R. 6), to C. C. Fletcher, L. F. Fletcher and E. E. Wakeman and their successors, as trustees, to hold title for the benefit of the eighteen grantors and their successors.

Petitioners have never operated the property (R. 27); they have never mined an ounce of bentonite (R. 27); they have no power to invest or reinvest and their powers and duties are strictly limited to the corpus originally conveyed to them in trust (Trust Instr., R. 7); the liability of the beneficiaries is not limited (R. 25); there is no provision for an office or other place of business, by-laws, minutes, books of account, meetings of beneficiaries, officers, employees, stationery or seal and never, during the entire life of the trust, have any such meetings been held or such business instrumentalities utilized (Trust Instr., R. 6 to 10; R. 25) transfers of shares of beneficial interest cannot be accomplished as are transfers of shares of corporate stock, but may be effected only by "the execution of an instrument of assignment executed in the manner required for the execution of deeds". (Trust Instr., R. 9.) The trust has never owned any mining machinery or equipment. (R. 27.)

Petitioners are empowered by the trust instrument "to manage and control the said property, to negotiate for the sale of and to sell, or to lease, to incumber, to contract for the development of, to mine upon, operate and develop the said property, or to otherwise handle or dispose of the said property or any part thereof to whom and upon such terms as the said trustees may deem best." (R. 24.) These powers are, however, coupled with an agency relationship between the trustees and the beneficiaries, for the trust instrument (Trust Instr., R. 7) continues: "and the said Trustees and their successors in trust are hereby made, constituted and appointed attorneys-in-fact for each of the parties hereto or their successors in interest."

The actual activities of the petitioners' trust (R. 26, 27) may be summarized as follows:

(a) From the date of its formation in 1929 to 1940 it did nothing but perform assessment work required by law to hold title to its placer claims.

(b) Beginning in 1940 and continuing into 1942, the trust entered into seven transactions (R. 26, 27). Three of these were sales of a specified number of tons of bentonite in place in the ground; one was a sale of bentonite in place in a described area of land; two were sales of a portion of the bentonite land as land; and the seventh and last transaction was a sale of the entire remainder of the land constituting the corpus of the trust. All were irreparable and final dispositions of trust corpus.

Such are the main facts in this controversy. On them the Court below held the income of petitioners' trust taxable as that of an association or corporation; not, however, because of what the trust did, but because of the powers granted in the trust instrument. In other words the tax was sustained below not because the Bentonite trust *actually* had income from operating a business, but because of granted but admittedly unused powers in the trust instrument.

## IV. REASONS RELIED ON FOR ALLOWANCE OF THE WRIT

(1) *The United States Circuit Court of Appeals, Tenth Circuit, and the United States Circuit Court of Appeals, Sixth Circuit, are in head-on collision on the test to be applied to determine whether a trust is taxable as an individual or as an association.*

*Tenth Circuit*

" . . . it is now well settled that the character of an organization in respect to being formed for the promotion of business purposes must be determined by reference to the terms of the trust . . .; that parties are not free to say that the pur-

*Sixth Circuit*

"It is contended by the petitioner that it was not competent to controvert by parol testimony the plain terms of the written instruments creating the trusts and that the purpose of their creation and taxability must be determined from the language

pose was other or more narrow than that set forth in the trust instrument . . .; and that it is no escape from taxation as an association to say that all of the powers granted were not exerted in full measure." (*Opinion below*, R. 93.)

appearing in the instruments. *This concept must be rejected. The crucial test* in determining whether a trust is an association, taxable as a corporation *must be found in what the trustees actually do* and not in the existence of long unused powers." (Com. v. Gibbs - Preyer Trusts, Nos. 1 and 2 (CCA 6, 1941), 117 Fed. 2d. 619, 622, 623) (Emphasis supplied).

To the same effect: *Cleveland Trust Co. v. Com.* (CCA 6, 1940), 115 Fed. 2d. 481; Cert. Denied (1941), 312 U. S. 704.

(2) *The United States Circuit Court of Appeals, Tenth Circuit, has decided an important question of Federal law, which has not been but should be settled by this Honorable Court.*

(a) Section 161 (a) of the Internal Revenue Code, so far as material here, is as follows:

> "Sec. 161 (a). Application of Tax.—The taxes imposed by this chapter upon *individuals* shall apply to the *income* . . . of any kind of property held in trust . . ." (Emphasis supplied.)

The uncontradicted evidence in the entire record in the instant matter shows that the income upon which the disputed tax has been laid and collected is income "of property held in trust." Nor is there in the entire record a contrary finding or holding. Petitioners' contention in the Court below was that, *inasmuch as the taxable entity here involved is actually a trust;* and, because the record shows that *its income is actually from property held in trust*, as distinguished from income produced by the *operation* of a busi-

ness, it came squarely within the command of Section 161 (a), supra; and, consequently, that the only tax that the United States is empowered to collect from petitioners' trust is the same character of a tax that it would collect from an individual under the same circumstances. The Court below disposed of this contention by holding (Opinion below, R. 91, 92) that, because Section 901 (a) of the Internal Revenue Code defined the term "corporation" to include the term "association" and because petitioners' trust was held to be an association, Section 161 (a) had no application.

We submit that the question of whether or not the *substantive* provisions of law in Section 161 (a), relating to the taxation of income *actually* from property merely held in trust, are to be controlled by the *definition* of the term "corporation" in Section 901 (a), *is a question of law that should be settled by this Honorable Court.*

We submit that the income of a *true trust actually from property held in trust could not, because of Section 161 (a)*, be taxed as that of an association, even if the mode and form of the trust organization were similar to that of a corporation.

(b) Petitioners' powers and duties are limited by the trust instrument (R. 6) to the six placer mining claims originally conveyed to them in trust and thus every transaction here in view, whereby part of the trust corpus was converted into cash, was a step in the ultimate liquidation of said trust, petitioners being powerless to make other investments for the trust.

We submit that the question of whether or not a trust in the process of liquidation may be classified and taxed as a going, operating business association, with income from its business *operations*, is a question of law that has never been, but should be, settled by this Honorable Court.

(3) *The United States Circuit Court of Appeals, Tenth Circuit, has disposed of the instant matter in a manner probably in conflict with applicable decisions of this Honorable Court.*

(a) Since the decision of *Crocker v. Malley*, 249 U. S.

223, in 1919, down through the decision of *Morrissey et al. v. Commissioner*, 296 U. S. 344, and its companion cases in 296 U. S., decided in 1935, *this Honorable Court has never held a trust taxable as an association on income arising exclusively out of the mere holding of property in trust.* The income taxed as that of an association in all of such decisions has, *invariably*, been produced by the *operation* of a business enterprise and, thus, the provisions of Section 161 (a), Internal Revenue Code, have not been violated.

The record in the instant matter shows that the income of petitioners' trust, on which the disputed tax has been laid and collected, was, exclusively from the mere holding of property in trust and there is no evidence, finding or holding to the contrary.

(b) In *A. A. Lewis & Co. v. Commissioner* (1937), 301 U. S. 385, this Honorable Court held that where a tract of land, title to which was in a trustee, was subdivided and sold under the direction of a real estate agent, the trust was not taxable as an association. The record in the instant matter (R. 24) shows that the trustees of petitioners' trust were, by the trust instrument, "made, constituted and appointed attorneys-in-fact for each of the parties hereto and their successors in interest"; thus, we contend, creating an agency relationship between them and the beneficiaries, so that the trustees acted in a dual capacity: (1) As *trustees* they held legal title to the corpus of the trust; and, (2) As to every other act they were mere *agents* of the beneficiaries, by virtue of the powers of attorney above set out.

(c) In *Morrissey et al. v. Commissioner* (1935), 296 U. S. 344, this Honorable Court set out five characteristics of a trust that would, if present in a proper case, make the trust akin to a corporation, therefore making the trust taxable, if it were operating a business enterprise, as an association. One of those characteristics was limitation of personal liability of the benfieciaries to the property embarked in the undertaking. Another was transferability of shares of beneficial interest in a manner similar to that followed in transferring the shares of a corporation. In petitioners' trust the liability of beneficiaries is not so limited (R. 25;

Opinion below, R. 92) and certificates of interest may be transferred only by the execution of a separate instrument of assignment having the formalities of a deed (R. 24, 25). Another distinction between petitioners' trust and an association or corporation is that beneficiaries of petitioners' trust who fail to contribute their pro rata share of the expense of assessment work required to be done to hold title to the property (placer claims) constituting the corpus of the trust, may be "sold out" by the trustees acting under authority granted (R. 25).

(4) *The United States Circuit Court of Appeals, Tenth Circuit, has so far departed from the accepted and usual course of judicial proceedings, or has so far sanctioned such a departure by the trial Court, as to call for an exercise of the power of supervision by this Honorable Court.*

It is axiomatic in the judicial administration of the income tax laws of the United States that substance and not form is controlling; that men are taxed according to the results of the transactions into which they have entered; and that facts may not be gainsaid. But petitioners' trust is here held liable to the disputed tax, *not because of the exercise of powers granted in the trust instrument to operate the property, but because of the mere existence of those powers, admittedly unused.*

It is equally well settled that taxing statutes are not to be extended by construction beyond the plain meaning of their terms and that the command of a statute may not be disregarded. Yet the Court below has held petitioners' trust liable to tax as an association on income admittedly from property held in trust, despite the command of Section 161 (a) of the Internal Revenue Code that "The taxes imposed . . . upon *individuals* shall apply to the *income* . . . of any kind of property held in trust . . ." (Emphasis supplied.)

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, Tenth Circuit, commanding that Court to certify and to send to this Honorable Court for its

review and determination, on a day certain to be therein stated, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 3095, C. C. FLETCHER AND E. E. WAKEMAN, as surviving Trustees of the Standard Bentonite Company, a trust, Appellant, vs. FRANK G. CLARK, as Collector of Internal Revenue for the Collection District of Wyoming, Appellee, and that the judgment of said United States Circuit Court of Appeals, Tenth Circuit, be reversed by this Honorable Court and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioners will ever pray.

C. C. FLETCHER AND E. E. WAKEMAN,
as surviving Trustees of the Standard
Bentonite Company, a trust,

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